



DEPARTMENT OF THE NAVY
NAVAL AIR SYSTEMS COMMAND
NAVAL AIR SYSTEMS COMMAND HEADQUARTERS
1421 JEFFERSON DAVIS HWY
ARLINGTON, VA 22243 -5120

IN REPLY REFER TO

NAVAIRINST 7040.13J
AIR-7.6.3
5 May 97

NAVAIR INSTRUCTION 7040.13J

From: Commander, Naval Air Systems Command

Subj: DEFINITIONS OF EXPENSE AND INVESTMENT COSTS

Ref: (a) Section 8052 of the FY 1997 Department of Defense (DOD) Appropriations Act,
P.L. 104-208 of 30 Sep 96
(b) Section 364 of the FY 1997 Department of Defense (DOD) Authorization Act,
P.L. 104-201 of 23 Sep 96

Encl: (1) Extract from the Assistant Secretary of the Navy (FM&C) Financial
Management Policy Manual NAVSO P-1000 (075001)
(2) Extract from the DOD Financial Management Regulation 7000.14R Volume 2A
(010201)
(3) Definition of Federal Information Processing Resources
(4) Unit Cost for Federal Information Processing Resources
(5) Federal Information Processing Equipment Appropriation Responsibility
(6) Investment Cost Decision Diagram

1. Purpose. To provide updated definitions of expense and investment costs and promulgate the fiscal year (FY) 1997 expense/investment and capital purchase thresholds set forth in reference (a).

2. Cancellation. This instruction supersedes NAVAIR Instruction 7040.13I of 30 January 1996 in its entirety, thus changes are not indicated.

3. Cost Definitions. All costs are classified as either expense or investment in accordance with the guidelines set forth in paragraph 4 of this instruction.

a. Expenses are the costs of resources consumed in operating and maintaining the Department of Defense. Within the NAVAIR claimancy, the Operation and Maintenance and the Research, Development, Test and Evaluation (RDT&E) appropriations finance expenses. Note: The RDT&E appropriation can also finance investment costs subject to the guidelines of paragraph 4 of this instruction.

b. Investments are the costs of major weapon systems, equipment and real property. Investment costs are financed by the Aircraft Procurement; Weapons Procurement; Other Procurement; Procurement of Ammunition; Shipbuilding and Conversion, Navy; RDT&E, and Military Construction procurement appropriations.

c. Navy Working Capital Fund (NWCF) and Major Range and Test Facility Base institutional (i.e., overhead) RDT&E costs may be either expense or investment costs (i.e., capital assets or major test and evaluation investments respectively). Expenses are reflected in the operating budget and investments are reflected in the capital budget. Expense and investment costs are financed by NWCF with reimbursement from the customer's appropriated funds. NWCF costs are further defined in NAVCOMPT Manuals Volume 5 and 8, the Financial Management Policy Manual NAVSO P-1000 (074600) and the DOD Financial Management Regulations (FMR) 7000.14R, Chapter 9 of Volume 2B and Volume 11B. RDT&E costs are further defined in NAVSO P-1000 (074400, 075400) and DOD FMR 7000.14R, Chapters 1 and 5 of Volumes 2A and 2B respectively.

d. Enclosures (1) and (2) contain detailed definitions of expense and investment costs, and will be reissued shortly to reflect the revised expense/investment monetary threshold addressed in this instruction.

4. Funding Policy. The revised expense/investment and capital purchase thresholds are discussed below.

a. Reference (a) upheld the expense/investment threshold in effect for FY 1996. Purchases (i.e., obligations) of non-centrally managed items made with FY 1996 and outyear appropriated funds with a unit cost of \$100,000 or less are considered expenses funded from appropriations available to DOD for operation and maintenance. Purchases of non-centrally managed items with a unit cost greater than \$100,000 are investments funded from appropriations available for investments.

b. Reference (a) does not apply to purchases of non-centrally managed items made with FY 1995 and prior year appropriations. Specifically, purchases of non-centrally managed items made with FY 1995 appropriated funds with a unit cost of \$50,000 or less are considered expenses funded from appropriations available to DOD for operation and maintenance. Purchases of non-centrally managed items exceeding the \$50,000 threshold are investments funded from appropriations available for investments. Purchases of non-centrally managed items made with FY 1994 appropriated funds with a unit cost of \$25,000 or less are considered expenses funded out of the appropriations/funds available to DOD for operation and maintenance. Purchases of non-centrally managed items in excess of the \$25,000 threshold are investments funded from appropriations/funds available for investments.

c. Reference (b) confirmed the above change in the expense/investment threshold and revised the capital purchase threshold. For purchases/obligations made during FY 1996 and the outyears, the NWCF unit cost threshold for an expense is \$100,000 or less and will be financed within the operating budgets of the business areas. NWCF Capital Budgets will include items of investment costing more than \$100,000.

- d. FIP resources are defined in enclosure (3).
 - e. Enclosure (4) defines the "unit cost" principle as it applies to federal information processing (FIP) resources.
 - f. Enclosure (5) provides appropriation decision diagrams by fiscal year for FIP purchases.
 - g. Enclosure (6) is a model to assist in determining if an item is an expense or investment cost.
5. Action. Addressees are requested to utilize this instruction in planning, programming, and budgeting for their programs. Questions concerning this material may be addressed to Cindy Meyer, AIR-7.6.3, on DSN 664-2211 or commercial (703) 604-2211 extension 6445.



S. W. Vance
Comptroller

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DEPARTMENT OF THE NAVY
ASSISTANT SECRETARY OF THE NAVY
(FINANCIAL MANAGEMENT & COMPTROLLER)

NAVSO P-1000



FINANCIAL MANAGEMENT POLICY MANUAL



0512LP7542000

Enclosure (1)

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Chapter 5**FINANCIAL RESPONSIBILITY****PART A: GENERAL FUNDING POLICY****075000****SCOPE**

In the exercise of assigned responsibilities, the Comptroller of the Navy determines budget and funding responsibilities between appropriation/accounts and between organizational entities of the Department of the Navy. The establishment of financial responsibility is based upon the legal scope of items and functions which can be funded from an appropriation and the Comptroller interpretations of various Office of Management and Budget and Office of the Secretary of Defense regulations. Part A of this Chapter provides general financial policies within DON which are utilized to assign funding responsibility. Parts B and C provide policy guidance for operation and investment programs respectively. Policy for research, development, test and evaluation programs is provided in Part D. Finally, funding guidance for morale support activities is provided in Part E.

(Change 48)

075001**EXPENSE/INVESTMENT CRITERIA**

1. GENERAL. Costs budgeted in and financed by the Operation and Maintenance, Military Personnel, Retired Pay and Foreign Currency Fluctuation appropriations (including those for Reserve components) are considered expenses. Costs budgeted in and financed by the Procurement and Military Construction appropriations (including those for Reserve components) are considered investments. Costs budgeted in and financed by the Research, Development, Test and Evaluation; *Base Realignment and Closure*; Civil Defense; Family Housing; Foreign Currency Fluctuation, Construction; Civil Functions; and Military Assistance Program appropriations include both expenses and investments.

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2. **EXPENSES.** Expenses are costs of resources consumed in operating and maintaining the Department of Defense. The following criteria will be used to determine those costs to be classified as expenses:

1. labor of civilian and military personnel, including contractual labor;
2. rental payments on leases for equipment and facilities;
3. food, clothing, and petroleum, oil, and lubricant (POL) items;
4. expendable supplies and materials;
5. items designated for *DBOF* management in the central supply system. These include items actually issued from inventory and standard items (i.e., listed in the Supply Management Lists) which are not stocked in the supply system but are authorized for local purchase;
6. maintenance, repair, overhaul, and rework of investment items, including real property facilities;
7. assemblies, spares and repair parts which are not designated for centralized individual item management by an inventory control point in the central supply system; i.e., not designated as Appropriation Purchases Account or Marine Corps Appropriation Stores Account;
8. general motion picture procurement and development;
9. all other equipment items not in the proceeding categories that have a unit value of *\$50,000 or less* and which are not designated for centralized individual item management by an inventory control point in the central supply system; i.e. not designated as Appropriation Purchases Account or Marine Corps Appropriations Stores Accounts

3. **INVESTMENTS.** Investments are costs of capital assets of the Department of Defense such as real property and equipment that provide new or additional military capabilities or maintain existing capabilities. The following criteria will be used to determine those costs to be classified as investments.

a. Equipment. All items of equipment, including assemblies, spares and repair parts, which are subject to centralized individual item management and asset control by an inventory manager or an inventory control point in the central supply system, including items designated as Appropriation Purchases Account or Marine Corps Appropriation Stores Account. This excludes items designated for *DBOF* management.

b. Other Items of Equipment. Other items of equipment, except for those designated as expense under subpar. 2, having a system unit cost of *more than \$50,000* are investment items. The system unit cost is not increased for transportation and installation charges, nor is it decreased for early payment discounts and trade-in allowances. This criterion does not apply to *DBOF* inventory items that are coded depot level repairables. The concept of a system must be considered in application of this criterion. A system shall be considered to exist if a number of components are part of and function within the context of a whole to satisfy a documented requirement. The term "system unit cost" applies to equipment items in the following ways, depending on the applicability of the concept of a system:

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- (1) the items are being acquired as a new system, i.e., the items are a part of and function within the context of a whole to satisfy a documented requirement; in this case, "system unit cost" applies to the aggregate cost of all equipment items being acquired as a new system;
- (2) the items are being acquired as additions to or replacements within an existing system in combination to address validated deficiencies or improve system performance; in this case "system unit cost" applies to the aggregate cost of all new equipment items being acquired in the same manner as a new system procurement;
- (3) the items are being acquired to satisfy a documented requirement on a stand-alone basis, or as additions to or replacements within an existing system and the items themselves are not characteristic of a system as described above; in this case, "system unit cost" applies to the individual equipment item.

Requirements may not be fragmented in order to circumvent this criterion. All due caution must be exercised in defining requirements to avoid the acquisition in a piecemeal fashion of items which function as a system.

c. Construction. Construction, including the cost of land and rights therein (other than leasehold), is the erection, installation, or assembly of a new facility; the addition, expansion, extension, alteration, conversion, or replacement of an existing facility; the acquisition of a facility, or the relocation of a facility from one installation to another. Construction is distinguished from repair or maintenance in that repair or maintenance has the effect merely of keeping the facility in its customary state of operating efficiency without the expectation of added future benefits. Construction includes equipment installed and made part of such facilities, and related site preparation, excavation, filling, landscaping, and other land improvements.

d. Ship Conversion. The cost of labor, kits, assemblies, equipment and material for ship conversion.

e. Other. Any cost designated as expense under subpar. 2 when included in the production or construction of an investment item, except for military personnel.

4. **CONDITIONAL CASES**. The following are conditional cases which take precedence over the criteria contained in subpars. 2 and 3.

a. Initial Outfitting. Initial outfitting of a major end-item of equipment, such as a ship or aircraft, with the furnishings, fixtures, and equipment necessary to make it complete and ready to operate is part of the initial investment cost. All items making up the initial onboard load, including spares physically included with the item for which the spares are intended (e.g., for aircraft, spares physically stored within the operating aircraft), are investment costs even though the items may be an intrinsic expense. Additionally, increased allowances incident to modification of the item or correction of initial outfitting deficiencies are investment costs. If a single procurement of an intrinsic-expense item is for the purpose of both the initial on-board load and other inventory, the procurement will be financed through the stock fund

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and that portion required for the on-board load will be reimbursed by the procurement appropriation which finances the end item. The costs of replacing intrinsic expense items making up the initial onboard are expenses. (See par. 075364 for additional guidance).

b. Installation of Equipment. The installation costs of equipment, as an integral part of having a complete and usable end item, are funded in the same appropriation in which the end item is purchased. Equipment installation is either a construction or a non-construction cost. For installed "built-in" equipment (real property) or accessory-type movable equipment (personal property) which is part of a military construction project, installation is considered a construction cost and financed from the appropriations available for construction. If the equipment is not associated with a construction project, its initial installation is financed with the same appropriation used to purchase the equipment. Costs of relocation or reinstallation of present, previously installed equipment not associated with a military construction project is considered an expense to be financed by the operating funds of the activity involved.

c. Ammunition and Explosives. Ammunition and explosive (Federal Supply Classes in Group 13) are investments even though they are consumed in use.

d. Modification and Maintenance. Modification is the alteration, conversion, or modernization of a major end item or equipment which changes or improves the basic character, purpose or operational capacity in relation to effectiveness, efficiency or safety. Maintenance is the routine, recurring work conducted to maintain a major end-item or equipment at its intended capability or designed performance. Budgeting for costs to accomplish modification and maintenance of investment items in operational inventory is prescribed below.

- (1) Modification. The cost of modification kits and assemblies provided to an installing activity and of the associated installation is an investment regardless of unit cost. All items included as part of a modification kit are considered investment even though the individual items may be an intrinsic expense.
- (2) Maintenance. The cost of labor, material, items designated for stock fund management, and equipment to be incorporated into the investment item as a requirement for maintenance is classified as expense. This includes the replacement of equipment and assemblies which are installed in a major end-item such as a ship or aircraft. However, items of equipment utilized during maintenance for which an inventory control point maintains centralized individual item management in the supply system (Appropriation Purchases Account and Marine Corps Appropriation Stores Account) are classified as investment costs.

e. Construction Program Costs. Construction program costs, such as program development, procurement management, contracting offices, contract audit offices, systems project offices, and other costs associated with construction management in general, as distinguished from supervision of

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specific construction projects, are expenses. Costs incident to the acquisition (e.g., design, direct engineering, technical specifications) and construction of a specific project are investments. The costs of administering military construction programs above Corps of Engineer and Public Works district levels are expenses, except that the costs of the acquisition function performed at the Headquarters, Naval Facilities Engineering Command are investments. The costs of administering military construction programs at district levels and below are investments. The costs of administering the real property maintenance program are expenses at all levels.

f. Minor Construction. Costs of minor construction projects not financed by Military Construction appropriations or the Construction category of the Family Housing appropriations will be considered expenses. However, this definition in no way abrogates the prohibition against the planned acquisition of, or improvement to, a real property facility through a series of minor construction projects, i.e., incremental construction. Minor construction will continue to be reported and reflected in the DoD real property inventory.

g. Maintenance and Repair of Real Property. Repair or maintenance has the effect of merely keeping the facility in its customary state of operating efficiency without the expectation of added future benefits. Thus, repair and maintenance of a real property facility is classified as expense. This includes the replacement of facility components, including that equipment which is installed or built-in as an integral part of the facility (included within Class 2 property).

h. Procurement/Production Program Costs. The cost of civilian personnel compensation (including benefits) and other direct expenses (travel, office equipment and automatic data processing leasing and maintenance, supplies, printing and reproduction) incurred in support of procurement/production programs by Department Headquarters staff (Secretariat, Office of the Chief of Naval Operations, and Headquarters, U.S. Marine Corps), contracting offices, contract audit offices, systems project offices, and acquisition managers are expenses. Project office and acquisition manager support services obtained from in-house field activities or by contract are considered direct procurement support costs and are thus classified as investments when integral to the execution of procurement programs under the cognizance of the project office or manager. Additionally, procurement/production direct support costs such as: production testing, quality assurance, production engineering, and equipment assembly, whether performed under contract or in-house are investments (see pars. 075341 and 075342).

i. Commissioning Ceremony. The costs of the ship commissioning ceremony for newly constructed or converted ships are to be funded as part of the investment cost (see par. 075373).

j. Lease Agreements

- (1) Scope. For purposes of expense/investment funding determinations, leases will be categorized and funded as specified in subpars. (2), (3), and (4).

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- (2) Lease. A "straight" lease is an agreement which simply conveys the right to the use of real or personal property for 12 months or less. Payments made for a straight lease are operating costs and, regardless of the amount, are expense funded. An agreement requiring periodic payments in excess of straight lease costs leads to ownership and is considered an installment purchase. In this instance, the payments may not be split funded between expense and investment funds, but must be viewed in total and fully funded as dictated by the unit value limitation contained in the expense/investment criteria.
- (3) Lease-to-Ownership. In a lease-to-ownership agreement, ownership of the real or personal property will automatically pass to the Government upon completion of a specified lease period. The lease payments must be no more than those required for a straight lease of the same item/property and additional payment for ownership must not be required. Lease-to-ownership agreements must not obligate the Government for a period of more than 12 months, notwithstanding the fact that the right to renew the agreement for successive 12-month periods can be secured through multiple options to renew. Lease-to-ownership agreements are categorized as operating costs and are financed by appropriations/funds available for expenses.
- (4) Lease-Purchase. Lease-purchase agreements allow the Government to acquire ownership of the item/property by making payment pursuant to a purchase option written into the agreement. Expense funding will be used for the lease phase of the agreement if the lease payments do not exceed a straight lease cost and the lease term, exclusive of renewal options, is for a period of 12 months or less. Payments made pursuant to the purchase phase of the agreement, either as lump sum, periodic, or a combination thereof, will be made from investment funds if the aggregate cost exceeds the established expense/investment threshold. Payments made as expense during the lease phase of the agreement will remain operating costs as initially charged regardless of subsequent ownership/purchase option decision. Once ownership has transferred to the Government, further payments for the lease phase of the agreement are precluded.

5. RELATIONSHIP WITH REVOLVING/MANAGEMENT FUNDS. The criteria contained in this paragraph do not apply to revolving/management funds since these funds are governed by separate regulations. For example, DBOF activities are authorized to finance certain industrial equipment classified as an investment. However, the use of appropriations provided on a customer order to a DBOF activity is governed by expense/investment criteria and other guidance and restrictions governing the use of appropriations. For example, an Operation and Maintenance, Navy-funded customer order cannot be utilized by a DBOF activity to finance customer equipment classified as an investment.

(Change 64)